

# Report of the auditor-general to the Free State Legislature and the council on the Maluti-A-Phofung Local Municipality

## Report on the financial statements

### Introduction

1. I have audited the financial statements of the Maluti-A-Phofung Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act no. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act no. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## Basis for qualified opinion

### Receivables from exchange transactions

6. The municipality did not calculate the allowance for impairment of receivables from exchange transactions~~consumer debtors~~ in accordance with SA Standards of GRAP, GRAP 104, *Financial instruments*, as there were ~~an error~~s in the debtors age analysis~~impairment calculation formula~~. Consequently, the allowance for debt impairment was understated and consumer debtors overstated by R63 423 818 in note 6 to the financial statements. Additionally, there was a resultant impact on the deficit for the period and on accumulated surplus.

### Repairs and maintenance

7. During 2015, I was unable to obtain sufficient appropriate audit evidence regarding repairs and maintenance due to inadequate record management. I was unable to confirm repairs and maintenance by alternative means. Consequently, I was unable to determine whether any adjustments to repairs and maintenance stated at R461 075 119 in note 36 to the financial statements were necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

### Qualified opinion

8. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Maluti-A-Phofung Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### Irregular expenditure

10. As disclosed in note 53 to the financial statements, the municipality incurred irregular expenditure of R117 547 638 (2015: R30 761 895) due to non-compliance with supply chain management (SCM) requirements.

### Significant uncertainties

11. With reference to note 45 to the financial statements, the municipality is involved in a legal dispute over the validity of an electricity maintenance contract as the municipality believes the contract is invalid. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements. The matter has been disclosed as a contingency of R8 700 000 000 (2015: R2 000 000 000) for royalties in the financial statements.

## Fruitless and wasteful expenditure

12. As disclosed in note 52 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R143 935 032 (2015: R73 558 891) due to interest charges on the late payment of suppliers.

## Going concern

13. Note 49 to the financial statements indicates that the municipality incurred a net loss of R880 681 939 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R1 430 323 863. The municipality has been making pension, medical aid and pay-as-you-earn deductions from employees' salaries, but has been unable to pay over R12 887 729 (2015: R8 298 635) of these amounts deducted to the relevant third parties. In addition, the municipality owed Eskom R1 345 396 146 (2015: R877 907 052) as at 30 June 2016, which was long overdue. These conditions, along with other matters set forth in note 49, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

## Restatement of corresponding figures

14. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

## Material impairments and losses

15. As disclosed in note 4 to the financial statements, receivables from non-exchange transactions were impaired by R206 993 170 (2015: R126 771 537).
16. As disclosed in note 37 to the financial statements, electricity losses of R248 508 912 (2015: R696 226 415) and water losses of R12 402 225 (2015: R8 321 699) were incurred as a result of distribution losses.

## Additional matters

17. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Unaudited disclosure notes

18. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

## Unaudited supplementary information

19. The appropriation statement set out on pages x to x does not form part of the financial statements and is presented as additional information. I have not audited this statement and, accordingly, I do not express an opinion thereon.
20. The supplementary information set out on pages x to x does not form part of the financial statements and is presented as additional information. I have not audited these schedules

and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### Predetermined objectives

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Key performance area 2: basic service delivery on pages x to x.
23. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance area. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
24. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
25. The material findings in respect of the selected key performance area are as follows:

### Key performance area 2: basic service delivery

#### Usefulness of reported performance information

26. The FMPPI requires performance targets to be specific in clearly identifying the nature and required level of performance and to be measurable and specify the period or deadline for delivery. A total of 21% targets were not measurable.
27. The FMPPI requires performance indicators to be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 31% indicators were not well defined.
28. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 28% indicators were not verifiable.
29. A total of 30% of indicators did not relate logically and directly to an aspect of the municipality's mandate and the realisation of strategic goals and objectives as per the service delivery and budget implementation plan, as required by the FMPPI.

## **Additional matters**

30. I draw attention to the following matters:

### **Achievement of planned targets**

31. Refer to the annual performance report on pages x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness of the reported performance information in paragraphs 26 to 29 of this report.

### **Adjustment of material misstatements**

32. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of key performance area 2: basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness of the reported performance information.

### **Unaudited supplementary information**

33. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and accordingly I do not report on them.

## **Compliance with legislation**

34. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

35. Annual performance objectives and indicators were not established by agreement with Maluti-a-Phofung Water SOC and included in the municipal entity's multi-year business plan, as required by section 93B(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

36. Revisions to the service delivery and budget implementation plan were not approved by the council, as required by section 54(1)(c) of the MFMA.

## **Annual financial statements and performance reports**

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting

records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

38. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
39. The annual performance report for the year under review did not include the performance of the municipality and each external services provider and a comparison of the performance with set targets and comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the Municipal Systems Act.

## **Procurement and contract management**

40. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
41. Contracts were awarded to bidders based on preferential points that were not allocated and/or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations.
42. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
43. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

## **Expenditure management**

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
45. An adequate management, accounting and information system which accounted for creditors was not in place, as required by section 65(2)(b) of the MFMA.
46. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Conditional grants received**

47. The municipality did not evaluate its performance in respect of programmes funded by the energy efficient and demand side grant allocation, as required by section 12(5) of DoRA.

## **Revenue management**

48. An effective system of internal control for debtors was not in place, as required by section 64(2)(f) of the MFMA.

## **Asset management**

- 49. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
- 50. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

## **Human resource management and compensation**

- 51. The competencies of the chief financial officer, head of supply chain and financial and SCM officials were not assessed in a timely manner in order to identify and address gaps in competency levels, as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
- 52. Sufficient appropriate audit evidence could not be obtained that the municipality developed and adopted appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff, as required by section 67(d) of the Municipal Systems Act.
- 53. The municipal manager and some of the senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the Municipal Systems Act.
- 54. The annual performance agreements for the senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the Municipal Systems Act.

## **Internal control**

- 55. I considered internal control relevant to my audit of the financial statements, performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the performance report and the findings on compliance with legislation included in this report.

## **Leadership**

- 56. The leadership did not take timeous and adequate action to address internal control weaknesses, which resulted in non-compliance with applicable legislation and gave rise to fruitless and wasteful and irregular expenditure.
- 57. Leadership took action to address internal control weaknesses, which resulted in an improved audit outcome; however, this process was not implemented timeously, which resulted in a delay in the audit process.
- 58. Key management positions were vacant during the year under review. Critical vacancies were not addressed, which had a negative impact on the basic daily and monthly internal controls.

## Financial and performance management

59. Appropriate action was not taken to prevent irregular expenditure. This was mainly due to inadequate planning, which resulted in deviations from the procurement process that- did not meet the criteria for a valid deviation.
60. Management did not prepare accurate and complete financial and performance reports that were supported **and evidenced** by reliable information. This was due to lack of competencies and the reliance placed on consultants to provide information without management taking ownership.

## Governance

61. Although the governance structures made an effort to facilitate an improvement in the control environment of the local municipality, the impact was not significant, mainly because recommendations made by the internal audit division and audit committee were not adequately implemented by the executive management.

Bloemfontein

28 March 2017



AUDITOR - GENERAL  
SOUTH AFRICA

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